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POSTAL REGULATORY COMMISSION
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Annual Compliance Report, 2015) Docket No. ACR2015

INITIAL COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE (February 2, 2016)

Pursuant to Order No. 3027, the Association for Postal Commerce ("PostCom") submits these comments on the Annual Compliance Report ("ACR") for Fiscal Year 2015 filed by the United States Postal Service ("Postal Service") on December 29, 2015. While PostCom does not contest the Postal Service's compliance with its statutory responsibilities in FY 2015, the information presented in the ACR nevertheless raises several concerns of which the Commission should be aware. In short, the concerns PostCom outlined in its comments on the FY 2014 ACR have not been addressed—the Postal Service continues to make decisions that impose additional costs on mailers without creating corresponding efficiencies in the postal network, and costs to both the Postal Service and the industry continue to rise. PostCom urges the Commission to remain cognizant of this dynamic as it evaluates and makes recommendations regarding cost coverage and workshare discounts reported in the ACR.

I. USPS IS DRIVING MAIL IN THE WRONG DIRECTION

Through its price signals and operational decisions, the Postal Service has been driving mail upstream to less efficient operations. This has caused costs, through no fault to the mailing industry, to continue to increase as the USPS chases efficiencies that either do not exist or no longer exist due to decreased economies of scale and lost volumes. Two examples demonstrate how Postal Service actions have resulted in more costly and inefficient processing of mail.

a. FSS PREP REQUIREMENTS AND PRICE SIGNALS

The Postal Service has created a no-win situation for mailers through the combination of the fully implemented Flat Sequencing System ("FSS") requirements and the broader, erratic, and irrational price signals that the Postal Service has created in its last price increase. The Postal Service, whether intended or not, has altered rate relationships in a way that discourages efficient mail entry. PostCom contends that these inefficiencies manifest themselves in the reduced cost coverage of Flats mail reported in the ACR.

The Postal Service's changes impacting Standard Mail Carrier Route Flats in FSS zones are one example of such an inefficiency. The Postal Service has irrationally created disincentives for mailers and Mail Service Providers ("MSPs") to produce mail in the most efficient manner. In the past, the Postal Service has maintained that the most efficient, least-handled, lowest cost mail was Carrier Route, and it has priced its products accordingly. This pricing created incentives to co-mail to create mailings that would qualify these rates, thus reducing overall (industry + USPS) cost.

The current Flats pricing structure has undermined these incentives. The Postal Service is now seeking to process as much Flats volume as possible on FSS machines, rather than having it entered as Carrier Route. Yet its pricing decisions have discouraged preparation that would meet the Postal Service's goals. In its 2015 price change, the Postal Service established new destination entry prices for High Density and High Density Plus (Carrier Route) Flats containers destined for FSS zones.[1] At the same time, it eliminated FSS Facility and FSS Scheme Carrier Route price. These new FSS entry prices are higher than the Carrier Route FSS Facility and FSS Scheme prices they replaced. This price increase created a disruption in comail operations and is causing mailers to pull those ZIP codes out of comail in some cases and produce them as individual mailings.

The results are more bundles, less finely sorted pallets (Destination Sectional Center Facility ("DSCF") to NDC), and higher costs for the Postal Service. In some cases, mailings are now prepared in sacks and entered at the DNDC instead of the DSCF. In others, there is no dropship at all. In more pronounced cases, mailers are reducing the volume to FSS zones, and in the extreme cases, mailers are not mailing to FSS zones at all (that is, they have stopped prospecting to customers residing in FSS zones). Regardless of whether they stay in comail or mail individually, PostCom members and the mailing industry are seeing an increase in cost as mail is entered further upstream, at higher rates, and without the ability to take advantage of efficiencies created through comail operations. *See* ACR at 17 (noting decline in cost coverage in Standard Mail Flats and indicating that the "major change" in this category was "the migration of Carrier

[1] *See New Mailing Standards for Domestic Mailing Services Products; Final Rule*, 80 Fed. Reg. 25,528 at 25,532 (May 4, 2015) and Notice 123, *Price List* (effective May 31, 2015).

Route FSS pieces to Standard Mail Flats"). It appears, especially for High Density and High Density Plus mailings (which are still available in FSS zones), that the Postal Service upended the sortation and processing by singularly focusing on its desire to directly induct as much mail into the FSS system as it can, ignoring everything else that goes into a rational rate structure that sends clear and sound price signals to users.

Further creating inefficiency, the mandatory requirement to produce FSS scheme pallets at a minimum weight of 250 pounds increases the total number of Flats pallets that must be handled by both printers and the Postal Service and has substantially increased the number of lightweight pallets processed. The number of pallets created has been extreme, causing a major disruption to our members' automated processes (including palletizers, automated guided vehicles, and high bay warehousing). The most-effective material handling for the Postal Service and MSPs happens when pallets are fully utilized, which means when they are built to handle 2000 pounds. The cost to the USPS and mailers can only go up when handling more pallets/unit as doing so results in increased pallet inventory, increased transportation providing Mail Transport Equipment, more handlings loading and unloading trailers, and a greater need for warehousing space, among other cost increases. Instead of artificially limiting the use of pallets, the Postal Service should either focus on how to facilitate fully loaded pallets or develop another container (smaller pallet). The 250-lb requirement has left PostCom members wondering if this requirement change met the Postal Service's commitment to realize lowest combined (USPS + industry) costs. The Postal Service has not reported the cost savings they have realized from this new requirement, and no savings are evident in the cost coverage data in the ACR. *See, e.g.*, ACR at 17 (cost coverage of Standard Mail Flats decreased 3 percentage points from FY 2014).

b. HANDLING OF BUNDLES

Breakage of Flats bundles during sortation increases Flats processing costs. The Postal Service and industry are working jointly to decrease bundle breakage frequency. However, a primary contributor to this issue is that Flats bundles are being sorted on equipment designed for package sorting.

In the 2015 price change, the Postal Service included Periodical price signals intended to incent the production of containers that bypass bundle sortation. The price signals, however, did not achieve the desired result due to insufficient incentives.

These concerns could be alleviated if the Postal Service would utilize the strengths and capacity of the mailing industry and encourage comailing, commingling, copalletization and drop shipping through proper price signals. Doing so could drive more direct pallets to Destination Delivery Units ("DDUs"), thereby bypassing bundle processing, reducing costs, and enhancing service. In other words, if the Postal Service in fact wants product entered at the DDU, it should send price signals that encourage mailers to do so.

II. COST REDUCTIONS THAT DO NOT REDUCE OVERALL COSTS

PostCom, in its FY2014 ACR Comments said:

> If the Postal Service's cost-cutting efforts were simply ineffective, that would be unfortunate, but not cause for undue concern. But the efforts pursued by the Postal Service have relied primarily on the shifting of costs to mailers, rather than reducing the overall costs of processing the mail. Accordingly, the Postal Service's efforts have actually resulted in increased costs to the industry, as the costs to both mailers and the Postal Service have increased.

PostCom members believe that the cost reduction strategies the USPS has pursued and will pursue in the future need more reporting and oversight. This reporting would help ensure that the savings the USPS forecasts are realized and allow the Commission to engage in appropriate follow up and oversight to determine why savings were not realized.

For example, in relation to Standard Mail service performance, the Commission accepted and the USPS implemented load leveling in April 2014. The industry expected to see a substantial improvement in on-time delivery as a result of this initiative, but recent performance figures indicate this improvement has not occurred.

It is important to note that currently there is no way for industry to isolate the data necessary to compare service performance for the specific category of Standard Mail impacted by the Load Leveling change because it is a subset of a larger category reported by the USPS. The USPS reports service performance for a variety of categories of Standard Mail that would include mail subject to the Load Leveling change (*e.g.*, destination-entered Standard Mail in categories with 3/5-day service standards, of which there are multiple categories reported). None of these categories, however, breaks out service performance for pieces by the day of the week they are mailed, which is the subset that Load Leveling applies to (since the change only applies to DSCF pieces accepted before the day zero Critical Entry Time on a Friday or Saturday).

Accordingly, industry has access only to service performance data for the broader Standard Mail categories reported by the USPS. Looking at the USPS' quarterly service performance results from Quarter 3 FY2014 (when Load Leveling was first implemented), through to the end of FY2015 (approximately 1.5 years after the Load Leveling change), service performance for DSCF-entered flats (3-5 day service standard mail) went from an annual score of 84.8% in FY2013 (prior to the Load Leveling change), to 86.0% in FY2014 (showing slight improvement), and 84.6% in FY2015 (lowest performance in the 3 Fiscal Years).

It is difficult to determine from our limited view of the USPS' service performance data whether the Load Leveling changes had a positive impact on service performance, as intended. The Postal Service certainly could, and should be required to, make available data showing the service performance only for those pieces impacted by the Load Leveling change over the 3-year period starting from before the change to the end of FY2015. This data would enable the industry and the Commission to evaluate whether the change had the desired impact in improving service performance for that sub-category of DSCF-entered mail.

PostCom feels this is an important exercise to accurately conduct so that if the USPS considers additional changes in service standards in the future, it will do so with information regarding the actual outcome of prior changes, rather than just the intended outcome. Ideally, some analysis also should be performed on the impact to mail volumes as a result of service standard changes—such changes can significantly impact the service attached to the product, which may decrease customer demand. Further, not only would more detailed service performance data allow interested parties to analyze results against forecasts, but it would also allow them to monitor costs as an initiative is implemented to ensure savings are achieved.

Another example where cost savings may not have been realized is Network Rationalization. The Postal Service claimed large cost reductions would result from this initiative, yet the overall cost of the system continues to increase. Plus, the Postal Service is building a HUB network which considers using plants that it previously claimed had to be consolidated and/or closed for cost reduction purposes. Regardless of how the USPS rolls out this new initiative, it appears the Postal Service will continue to bear costs for processes and employees that may not be needed to handle ever-decreasing mail volume.

With the introduction of the 24 hour clock and the consolidation of facilities, PostCom members were concerned that at some point in Network Rationalization, because of distances from processing to delivery units, service would be disrupted and transportation costs would be impacted. Two areas of concern in this regard are Periodicals and High Density Saturation Flats and Parcels. Periodicals costs associated with purchased transportation, reported in Cost Segment 14, appear to have changed for the worse.[2] At the same time, however, starting in the first quarter of FY2015, the price of oil has dropped to levels not seen in many years. One might have expected this change to help lower Postal Service transportation costs in 2015, as it has helped American consumers to save on gasoline. But the transportation costs attributed to Periodicals <u>increased</u> in FY2015. The same is true for High Density Saturation Flats and Parcels, where this cost segment increased by 83 percent. As this product is entered mostly at destinating facilities, it is almost incomprehensible how these transportation costs could increase by such a large percentage in one year.

A further analysis of the Periodicals transportation costs shows that the increase occurred in the long-haul transportation segments, *e.g.*, Inter-SCF and Inter-NDC highway costs, but not in Intra-SCF or Intra-NDC transportation, as illustrated in the table below. While Intra-SCF and Intra-NDC transportation costs declined slightly, the inter-SCF and inter-NDC costs increased over 30 percent. Clearly, the added costs were incurred for those Periodicals that are not drop shipped and therefore require long-haul transportation, and not for those Periodicals that are drop shipped to destinating facilities. These increases are displayed in the table below:

Table 1: Major Categories of Outside County Highway Transportation Costs ($000) in FY2014 and FY2015

	INTRASCF HIGHWAY	INTERSCF HIGHWAY	INTRANDC HIGHWAY	INTERNDC HIGHWAY
FY14	88,711	45,979	20,736	23,430
FY15	84,825	58,753	19,269	30,208
FY14-15 Change	-4.38%	27.78%	-7.07%	28.93%

[2] *Compare* ACR FY2015 Library Reference "USPS-FY15-2 – FY 2015 Public Costs Segments and Components Report," FY15.Public Cost Segs and Comps.xls, Tab CS14, cell J:29 *with* ACR FY2014 Library Reference "USPS-FY14-2 – FY 2014 Public Costs Segments and Components Report," FY14.2.Public Cost Segs and Comps.xls, Tab CS14, cell J:29.

Volume Adjusted FY14-15 Change	-0.91%	32.42%	-3.70%	33.61%

Network Rationalization also impacted service for First-Class Mail. The Postal Service removed the overnight delivery performance standard, altering the delivery performance and providing the Postal Service with more time to deliver the mail. Despite this change, overall service performance has declined. The Postal Service proposed that altering the clock to allow for more efficient plant processing would allow it to improve overall delivery for 3 day services, supporting national mailer interests. This improvement has not yet occurred, and as a result, the USPS is reporting delivery that is worse than its performance prior to this change.

III. VOLATILTY IN COSTS RAISES SERIOUS CONCERNS

PostCom is concerned with the volatility it has seen in some of the cost changes from the FY14 ACR to the FY15 ACR, at least some of which appear to be emblematic of the inefficiencies described above. PostCom has submitted to the Chairman questions regarding many of these issues, hoping for resolution prior to the Commission's Order, and sets them out below for the purpose of ensuring the completeness of the record in this proceeding.[3] Of particular concern to PostCom are the following:

- <u>Dramatic Increases in Attributable Costs for Carrier Route Letter and High Density/Saturation Letters, Flats, and Parcels</u>

The ACR documents a series of increased attributable costs for Carrier Route Letters and High Density/Saturation Letters, Flats, and Parcels. In particular, the ACR indicates that attributable cost per piece of High Density/Saturation Letters increased from \$0.062 to \$0.070; the attributable cost per piece of High Density/Saturation Flats & Parcels increased from \$0.078 to \$0.105; and the attributable cost per piece of Carrier Route increased from \$0.188 to \$0.206.[4] The increase of attributable costs for these products is very disturbing. The mailing industry continues to provide mail in the manner in which the Postal Service dictates through its rules, requirements, and prices, and incurs

[3] *See* Motion of the Association for Postal Commerce for Issuance of Information Request (Jan 27, 2016) and Second Motion of the Association for Postal Commerce for Issuance of Information Request (Jan 29, 2016).
[4] *Compare* FY 2014 ACR at p.17, Table 2 with FY 2015 ACR at p.17, Table 2.

costs in doing so. Yet, time after time, when the ACR is published, the costs for this preparation increases, and the mailing industry learns that inefficiencies abound.

- <u>Lower Cost Coverage for Standard Mail Flats</u>

The FY 2015 ACR states that "Standard Mail Flats had a cost coverage of 80.2 percent in FY 2015, down 3 percentage points from FY 2014. The major change in Standard Mail Flats in FY 2015 was the migration of Carrier Route FSS pieces to Standard Mail Flats." ACR 2015 at 17. This statement triggers substantial concerns in the industry, and for the reasons stated above – given that the industry prepares mail in the manner directed by USPS, the Postal Service management appears unable to control costs, and appears to make decisions without regard to achieving the lowest combined (that is, Postal Service plus industry) costs. Furthermore, prices are established in a vacuum, without feedback or analysis from the industry prior to implementation.

- <u>Increased Delivery Costs, In Spite of FSS Processing</u>

The USPS has consistently justified the implementation of the FSS on the ground that although it is likely to increase processing costs, it will decrease delivery costs. Indeed, in the FY 2013 ACR, the Postal Service stated: "FSS has increased the mail processing costs of Flats as the sequencing activity has moved from delivery to mail processing. However, these increased costs are offset by lower delivery costs." USPS FY 2013 Annual Compliance Report at 23 (Docket No. ACR2013).

This promise was not achieved in the first year of FSS operation – delivery costs for Standard Mail Flats rose over 8 percent from FY 2013 to FY 2014 while at the same time, mail processing costs for Standard Mail Flats rose almost 9 percent. In this year's ACR, the Postal Service reports still more delivery cost increases. Specifically, for the two products most processed on FSS (Standard Mail flats and Periodicals Outside County), mail processing costs decreased by 0.36 percent and 4.5 percent, respectively, while delivery costs went up by 7.90 percent and 7.91 percent respectively. These delivery cost increases run directly counter to promises made by the Postal Service, and point to poor management and pricing decisions.

- <u>Significant And Unexplained Changes In Certain Cost Segments</u>

PostCom has always advocating using the Intelligent Mail platform to identify pain points within postal operations. There have never been more pain points as there are today from underperforming products, to black holes in the carrier unit, to mail dropping off of equipment. The Postal Service needs to use the data it collects itself and more from the industry to understand the operations that are costly and how to utilize technology and the industry to reduce costs, not pass it along. In particular, PostCom has identified the following significant cost changes (primarily increases) that require further explanation. Using the IMb could help identify changes in processing and handling that have led to the following cost changes:

- The 12.83% increases in High Density and Saturation Letters C/S 3.
- The 26.43 % decrease in EDDM C/S 3.
- The 22.11% increase in High Density/Saturation Letters C/S 6.
- The 8.84% increase in High Density/Saturation Flats and Parcels C/S 6.
- The 3.05% increase in Standard Mail Flats C/S 6.
- The 91.12% increase in Bound Printed Matter Flats C/S 6.
- The 29.38% increase in Bound Printed Matter Parcels C/S 6.
- The 25.57% increase in High Density/Saturation Letters C/S 7.
- The 20.63% increase in High Density/Saturation Letters C/S 10.
- The 97.12% increase in High Density/Saturation Flats and Parcels C/S 7.
- The 13.47% increase in Carrier Route C/S 7.
- The 43.32% increase in Standard Mail Flats C/S 7.
- The 83% increase in High Density/Saturation Flats and Parcels C/S 14.
- The 27.78% and 28.93% increases in Inter-SCF and Inter-NDSC, respectively, highway transportation costs attributed to Periodicals.[5]

IV. RADICAL CHANGES IN AVOIDED COSTS AND REAL LIFE IMPLICATIONS

Many factors go into the success of a direct marketing campaign, but two factors of particular significance are cost-per-piece and targeting a specific in-home delivery window. Direct marketers using Standard Mail push their MSPs to optimize their postage cost per piece and achieve in-home mail delivery window objectives to the best of their abilities. Achieving these objectives allows Direct Marketers to achieve their marketing and cost objectives and yield a positive return on investment. This positive return, in turn, entices direct marketers to make additional use of the Postal Service.

[5] *See* Library Reference "USPS-FY15-2 – FY 2015 Public Cost Segments and Components," Public Cost Segments and Components worksheet, CSS Summary tab.

Increasing such use is a highly-desired objective, since it lowers the Postal Service's unit costs, and thus the costs of direct marketers and others who make substantial use of the Postal Service system.

Since the service standards for Standard Mail do not guarantee a delivery window given a particular entry date, MSPs use every possible and practical mailing technique, including IMb Full Service, commingling, co-mail, co-palletization, shipment consolidation, and drop ship, to enter that mail as deep as possible into the Postal Service network with the least amount of handling and processing required by the USPS. The goal is to do as much work as possible before entering the USPS network, and to have the processing of that mail by the USPS take place with a minimum of handling and processing required by the Postal Service. This approach ensures that Standard Mail can be used with fairly predictable service results, and – all else being equal – should result in not only predictable but also lower USPS costs.

For these reasons, mailers are concerned about the volatility of costs reported in the ACR. Library Reference "USPS-FY15-3 – FY 2015 Discounts and Passthroughs of Workshare Items" reports that avoided costs for a number of activities have decreased by 95%--including Standard Mail Dropship DNDC and DSCF Letters, Standard Mail Carrier Route Dropship DNDC and DSCF Letters, and Standard Mail High Density Dropship DNDC and DSCF Letters. The Postal Service provides no explanation for these radical changes, and PostCom finds it difficult to believe that the costs associated with dropshipped mail could have changed so dramatically in a single year.

Furthermore, these cost avoidance figures, if correct, would suggest that the Postal Service should radically alter its pricing structure to incent customers to avoid drop entry of Standard Mail. Information presented in a recent MTAC meeting, however, suggests that such a serious course correction would have disastrous and costly consequences for the Postal Service and its customers. This information indicated that when the Postal Service performs 100% of handling and transportation of Standard Mail Letters on an End to End basis, its overall Service Performance score was 61.0% against a target of 91%. That score was based on 886.9 million End to End pieces, or approximately 9.6% of the total Standard Mail Letters in measurement. This level of performance would be unacceptable for mailers relying on a targeted in-home window to support their marketing and communications strategies. Such mailers have fast turnarounds, cadences and timing objectives that must be met to coordinate with all of their other communication media channel activities and back end operations (such as order fulfillment).

PostCom is highly concerned that the Postal Service's primary strategy to address the cost avoidance issues outlined above appears to be simply to avoid rate shock in future price increases rather than engage in a more comprehensive assessment of processing, costing, and pricing issues. We believe that it is instead high time to leverage the data being generated by the IMb and re-evaluate the current Postal Service model of looking at cost avoidance in individual silos or rate tiers. Marketers do not make decisions regarding whether to engage in workshare and dropship activity in this manner; instead, they evaluate the overall cost of a mail campaign and its ability to target the optimal customers at the optimal time and place against the expected return on investment. If the goal is to keep as many businesses using the mail channel as possible and grow mail volumes, then the Postal Service, the Commission, and the industry need look at the full and accurate costs of the actual mail volume that is received, the actual handling that mail undergoes, and the impact of that processing on service.

In sum, the picture painted by the ACR on cost avoidance is highly troubling, and PostCom respectfully requests that the PRC commence a dialogue to ensure that incumbent costing methodologies are not being used solely to prop up and support an infrastructure and costs that may no longer be justified.

V. CONCLUSION

PostCom respectfully offers the foregoing comments on the FY 2015 ACR. As noted above, the Postal Service appears to be using its existing infrastructure in an inefficient manner, and driving costs to mailers in a manner that does not reduce overall costs. In addition, the FY 2015 ACR illustrates a series of unexplained, and highly troubling, cost increases. These cost increases are a source of mystery to PostCom because of the fact that the Postal Service has putatively been shedding costs through its transfer of tasks (as reflected in the Postal Service's rules) to mailers.

PostCom respectfully requests that the PRC encourage the Postal Service to make better use of the data in its possession, particularly the IMb data, to analyze ways in which it can improve its processes and its pricing practices. PostCom also respectfully requests that the Commission encourage the Postal Service commence a dialogue with industry to explore these issues, as well as mutually-agreeable solutions.

Respectfully submitted,

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